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Venezuela: Challenges Facing the New Administration [redacted]

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An Intelligence Assessment

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Venezuela: Challenges Facing the New Administration [redacted]

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An Intelligence Assessment

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This paper was prepared by [redacted] Office of African and Latin American Analysis. It was coordinated with the Directorate of Operations. Comments and queries are welcome and may be directed to the Chief, South America Division, ALA, [redacted]

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Venezuela: Challenges Facing the New Administration [redacted] 25X1

Key Judgments

Information available as of 6 December 1983 was used in this report.

Venezuela's new President Jaime Lusinchi will face serious economic and political challenges when he takes office on 2 February 1984. Despite a solid majority of the presidential votes and majority control of the bicameral legislature, we do not believe that he will succeed in easing his country's financial difficulties or reviving the recession-ridden economy during his first year. [redacted] 25X1

Lusinchi is by most accounts [redacted] without well-formulated views on political and economic issues. The US Embassy believes that the magnitude of his victory represents more a repudiation of incumbent President Herrera and proof of the organizational capability of Lusinchi's Democratic Action Party (AD) than a vote of confidence in the President-elect's qualifications for the job. [redacted] 25X6 25X1

We and the US Embassy believe that his announced preference for a consensus approach to government will hinder his efforts to establish his authority over a divided ruling party, an influential labor sector that believes it will receive favored treatment from his administration, and unusually uncooperative opposition parties. Indeed, the combination of a humiliated and divided Social Christian Party (COPEI) and the AD's impressive victory—the largest since democratic government was restored in 1958—could undermine the traditional spirit of cooperation and shared economic and social objectives between the country's two dominant, centrist parties. [redacted] 25X1

We believe Lusinchi is likely to follow moderately expansionary economic policies, which are traditionally characteristic of Democratic Action administrations. This seems to us implicit in his statements both before and after the elections and would represent a compromise among various and competing economic advisers. Although reduced export earnings, which have fallen by over 30 percent from the 1981 peak, and pressures from international lenders will force Venezuela to implement some austerity, we believe Caracas feels relatively self-assured by its growing foreign exchange reserves, which have risen to over $11 billion, and its ability to cut imports by 40 percent since last February. Because of these two factors—and traditionally ardent nationalism—Caracas is unlikely to risk the political costs of seeking a formal IMF agreement. Lusinchi may instead seek an unofficial IMF "endorsement" of a self-imposed austerity program or some arrangement that would gain the Fund's stamp of approval with minimal conditionality. [redacted] 25X1 [redacted] 25X1

In the short term this could be a viable political and economic strategy, but neither it nor other feasible options are likely to be sufficient to move Venezuela out of recession over the next year. More importantly, Lusinchi's probable course will only postpone—and intensify—the structural adjustments the government would have to make to assure stable economic growth over the longer run. The government also will pay other costs: growing inflationary pressures, greater erosion in investor confidence in Venezuela's economy, and increased unemployment. Minor policy adjustments, especially to protect against any significant losses of labor backing, are likely. [redacted] 25X1

Venezuela's outlook—tough political sledding for President Lusinchi and continued economic stagnation—will adversely affect traditionally close relationships with the United States. Lusinchi rejects any idea of a special relationship between Caracas and Washington. If he continues his circumspect approach to foreign policy—and preoccupation with economic problems may incline him to do so—the foreign affairs arena will be left more open for the aggressive former President Carlos Andres Perez to implement his Third World views. Perez, in any event, is likely to be a growing power in the administration as he marshals forces for a run at the presidency in 1988. [redacted] 25X1

On the economic side, we believe that continued import and foreign exchange controls will sharply reduce US exports to Venezuela in 1984. Although we believe it is highly unlikely, Caracas could decide to carry out its threats of continued debt repayment moratoriums and even debt repudiation if it sees no progress in negotiating debt relief with foreign creditors. This would especially hurt US creditors, who hold 48 percent of Venezuela's $36 billion external debt. We believe that such an action, if successful, could set a precedent that other debtor nations might be inclined to emulate. [redacted] 25X1

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Introduction

Venezuela is paying the price of a decade of squandered petrodollars, economic mismanagement, and short-sighted political leadership. Like many other major developing countries, it cannot meet payments on its foreign debts and has been forced to suspend some debt repayment obligations, impose exchange controls, and severely cut imports. The rate of business bankruptcies is climbing, and unemployment, already at 11 percent by official estimates, continues to rise sharply; only costly price controls and subsidies are preventing soaring inflation. The government has been unwilling so far to make the structural changes the IMF and commercial bankers regard as necessary to correct the situation.

This paper examines immediate problems that will face the Lusinchi administration when it takes office on 2 February. These include the necessity to reach an accommodation with international lenders in order to refinance a large share of the country's $36 billion foreign debt and, at the same time, forge a national consensus on economic policies that can be supported by such divergent groups as labor and business. The paper also examines the personality of the President-elect, reviews the economic options available to him, and suggests his most likely choices. We construct a downside risk scenario to assess the political and economic ramifications of unsuccessful policies on Venezuela, and we review implications for the United States.

The Economy: Lusinchi's Inheritance

The crippled economy that Lusinchi will inherit reflects some strong external stresses that have occurred over the past several years: the decline in international oil prices, a lagging world economy, high interest rates on foreign loans, and growing unwillingness by international bankers to extend credit to Latin America. In our view, however, the impact of these problems has been substantially magnified by successive governments squandering the 1974-81 oil bonanza on consumption rather than investment in productive projects, failure to diversify the economy beyond the volatile oil sector, and poor management of foreign debt. 25X1

Venezuela's current financial predicament emerged in late 1982, as oil revenues dropped abruptly and triggered a loss of foreign lender confidence.[1] By early 1983 continuing losses of foreign exchange reserves—compounded by rampant capital flight that, at one point, reached $425 million a week—and bankers' demands for payment of maturing short-term debt caused Caracas to take measures to bolster its external payments position: 25X1

- At first the government introduced foreign exchange controls to limit the outflow of currency, devalued the bolivar to improve the payments account, and froze prices on all goods and services to prevent increases in the prices of imported foodstuffs and materials from triggering considerable domestic unrest.

- As its financial position continued to weaken, the government suspended principal payments on public-sector debt in March to gain some breathing room while it negotiated with the banks on rescheduling short-term credits. President Herrera, however, resisted international lenders' insistence on an IMF agreement. According to US Embassy sources, he apparently believed that adoption of an IMF austerity program—which would include unifying the exchange rate at a level determined by market forces, removal of price and import controls, and a sharp reduction in public expenditures—would doom the governing Social Christian Party's election chances. 25X1

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As an alternative to an IMF austerity program, Caracas used additional stopgap measures such as limiting the availability of dollars for imports. Venezuela managed to raise its hard currency holdings from $8.6 billion to over $11 billion in less than 10 months and has cut imports from $13 billion in 1982 to some $8 billion in 1983. Thus, Herrera leaves office with the large foreign reserve cushion necessary to allow the next administration some financial breathing room but with external debt refinancing renegotiations deadlocked—in part because of the delays in making debt servicing payments—and the internal economy seriously weakened. [redacted] 25X1

Although official Central Bank figures for 1983 are not yet available, projections made by international creditors, the IMF, and local business sources are, we believe, reliable indicators of the depth of Venezuela's domestic economic problems:

- GDP probably dropped 3 percent in 1983, a sharp decline from the dismal growth of only 0.6 percent in 1982. According to official government data, the decline in output boosted unemployment to about 11 percent, while some labor sources place the figure at 24 percent.

- According to the US Embassy, cutbacks in trade credits and shortages of raw materials and capital equipment have forced many firms to shut down. Those still in business are facing a profit squeeze because of price controls and declining sales.

- High interest rates and a slowdown in government and private investment have crippled the construction industry. According to the US Embassy, output continued to decline after a 27-percent drop in 1982.

- Price controls and subsidies kept the inflation rate at about 5 percent in 1983, but most Venezuelan experts believe prices would otherwise have risen about 20 percent. Although oil revenues—which constitute nearly 45 percent of government revenues—have stabilized, the IMF estimates that Venezuela will run a public-sector deficit in 1984 equivalent to about 4 percent of GDP. [redacted] 25X1

Venezuela's most onerous external problem is servicing its $36 billion debt—of which $29 billion is contracted by the government and $7 billion by the private sector. Creditor banks have demanded that $700 million in overdue interest on private debt be paid by the government as a precondition to refinancing the $18.4 billion in public-sector debt due by the end of 1984. [redacted] 25X1

Immediate Political Challenges

The President-elect has publicly stated that he considers his electoral landslide—nearly 57 percent of the vote—and his party's control of the Congress a mandate for attacking these economic problems. In attempting to craft and implement effective economic policies, however, we believe Lusinchi will face serious political hurdles that will prevent him from dealing immediately with economic problems. In particular, the ruling party itself is seriously divided into rival factions. He also will be under pressure to come to terms with labor and opposition Social Christian and radical leftist parties. His talent for conciliation, which helped gain him the nomination, could be useful in these areas, but overall he faces a difficult and entirely unfamiliar situation. According to the US Embassy, some of his political associates believe that he may not be up to the task [redacted] 25X6 25X6

Divisions in the Democratic Action Party. [redacted] 25X1 [redacted] 25X1 Lusinchi is a longtime party functionary with only a limited personal following and does not command the loyalty or enthusiasm enjoyed by other party officials. Because he lacks a political base of his own, [redacted] 25X1 he will encounter major obstacles when he tries to wield his authority over a party that has been described by one AD leader as little more than a collection of fiefdoms headed by independent and ambitious "barons." [redacted] 25X1

Jaime Lusinchi

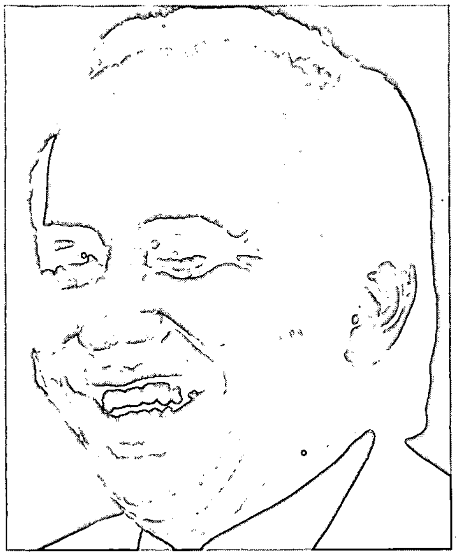
Elected by the largest majority ever accorded a Venezuelan presidential candidate, the 59-year-old pediatrician from eastern Anzoategui State is an enigma to most Venezuelans. A militant of the Democratic Action Party (AD) since 1941, Lusinchi was imprisoned, tortured, and forced into exile in 1952 after a military coup. His exile ended in 1958 with the restoration of democratic rule and his return to the Venezuelan Congress where he has served as deputy and senator. He has been actively involved in party politics, assuming a number of important posts that required an ability to resolve disputes and build consensus. He has weathered AD party splits and quarrels, usually managing to retain the respect and friendship of most factions. In 1978 he sought the presidential nomination with the support of outgoing President Carlos Andres Perez but lost to Luis Pinerua, a candidate backed by party founder Romulo Betancourt.

At a time when the party was suffering from major internal conflicts among the followers of Betancourt, Perez, and Pinerua, Lusinchi emerged as a consensus candidate, not strongly identified with any faction. According to the US Ambassador, Lusinchi achieved his present political position more through amiability and capable neutrality than by vision or strength of character. The Embassy has observed that his knowledge of economic issues is slight and his past comments on foreign affairs frequently lacked understanding or clarity.

Most US Embassy officers in Venezuela believe Lusinchi comes to office with few of the assets necessary to deal effectively with the country's serious problems. The personal characteristics that facilitated his rise in the party hierarchy are less desirable in a position that traditionally has operated best under a strong hand. Though Venezuela is a democracy, the historical tradition of the "caudillo" still appeals to most Venezuelans. 25X1

Lusinchi's advisers have gone out of their way to assure US Embassy officers that the incoming President will be his own man and will not accept tutelage from Perez or anyone else. Nevertheless, we believe his lack of knowledge on many foreign and domestic issues and his total lack of executive branch experience will make him at least initially dependent on the advice of others. Thus, we expect an unproductive struggle among his many advisers, a situation that all but paralyzed the outgoing Herrera administration in its last two years in office.[a] 25X1

[a] *This assessment is mainly based on information drawn from consultations with US Embassy officials in Caracas.* 25X1



Carlos Andres Perez—an ex-President and major power within the AD [redacted] UPI ©

A major power within the AD is former President (1974-79) Carlos Andres Perez, who is aggressively seeking the presidency for the next term that begins in 1989. Because of his forceful personality, international standing, and formidable reputation, Perez exerts great influence on public opinion and orchestrates his activities at home and abroad for maximum political impact. He appeals to the majority of Venezuelans who want their political leaders to be colorful, active, and commanding. His support of Lusinchi during the campaign was instrumental in the magnitude of AD's victory, in our view. [redacted]

Labor Expectations. The AD's Labor Bureau has been a pillar of the party since its inception in the 1940s, and labor representatives occupy high positions in party councils. One of their leaders, Manuel Penalver, is Secretary General of the AD, a post the US Embassy reports was acquired in a political deal with Lusinchi in exchange for labor support during his quest for the presidential nomination. Because of labor's role in the election, Labor Bureau spokesmen are predicting that the new government—and especially Lusinchi—will be totally committed to labor's social and economic objectives. This program, according to the US Embassy, first calls for price controls, wage indexing, and the introduction of worker participation in management of both state and private companies. Some AD labor leaders claim privately, according to US Embassy sources, that labor, through the AD, will run the government. [redacted] 25X1

We believe that labor rank and file is almost certain to press union leadership early in 1984 to seek a wage increase commensurate with labor's expectations of an inflationary surge. The US Embassy notes, however, that Lusinchi's political debts to labor will be difficult to reconcile with the more restrictive wage-price policy advocated by some economic advisers to weaken inflationary pressures [redacted] 25X1

According to the US Embassy, a high-ranking AD leader claims that Lusinchi intends to be his own man and not be bound by promises made to labor. In our view, this would almost certainly put the new president on a collision course with a sector whose cooperation, or at least acquiescence, is necessary to give the new government time to work out its policies. [redacted] 25X1 25X1

The Political Opposition

The Social Christian Party. The shattering loss of the Social Christian Party (COPEI) places the Democratic Action–Social Christian consensus of the past two decades on most foreign and domestic issues in serious jeopardy. The election has set the stage for the resumption of a bitter struggle for control of COPEI between outgoing President Herrera and the party's defeated candidate, former President (1969-74) Rafael Caldera. Caldera's efforts during the campaign to disassociate himself from the unpopular administration, and in turn Herrera's tepid support for him, have all but split COPEI into warring factions. According to the US Embassy, each group is now bent on the elimination of the other as a significant force within the movement, and we believe the power struggle will

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Table 1
Presidential Vote, 1978 and 1983

Party	1978		1983	
	Votes Cast	Percent	Votes Cast	Percent
COPEI	2,482,853	46.63	2,292,637	34.57
AD	2,307,917	43.34	3,770,647	56.85
MAS	274,230	5.15	276,263	4.17
Others	259,734	4.88	292,827	4.42

[redacted]

Table 2
Congress Vote, 1978 and 1983

Party	1978		1983 (Preliminary Tally)	
	Senate	Deputies	Senate	Deputies
Total	**44**	**199**	**47**	**201**
AD	21	88	29	113
COPEI	21	84	16	60
MAS	2	11	2	10
Others		16		18

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[redacted] 25X1

last for some time. For example, the aftermath of a bruising political campaign and Herrera's penchant for combativeness and settling old scores may surface in the new Congress, where—as a former president—he is accorded a senate seat. [redacted]

The election of congressional leaders on 23 January, when the new Congress meets, may provide an early indicator of the course that COPEI will pursue and the extent of damage to the spirit of bipartisanship. Since 1963 AD and COPEI have divided up major congressional leadership posts, maintaining an unofficial pact designed to ensure passage of essential legislation. We expect the election of congressional officers will be more contentious than at any time in recent history. Although COPEI, by itself, may not be able to block AD programs, its behavior will help set the tone for opposition to the government and suggest whether the traditional rules of the game that have underwritten two decades of democracy will still hold. [redacted]

The MAS (Socialist) Party. The election outcome was a bitter disappointment for the Movement Toward Socialism (MAS), whose hopes finally to establish itself as a strong leftist alternative to the two traditional parties had been sustained throughout the campaign by highly favorable polling results. MAS's poor showing has rekindled the longstanding internal debate over whether the party's future lies in uniting with radical leftist groups or in continuing to moderate its stance. According to the US Embassy, MAS hardliners are now blaming the movement's leader, Teodoro Petkoff, for alienating potential leftist voters by incorporating in his campaign many of the policies 25X1 followed by the two centrist parties. Party leaders have apparently decided to shelve their antagonisms 25X1 in the near term, but ideological and personal differences are sufficiently deep rooted to endanger the party's long-term survivability. [redacted]

A major reason for the continued cohesion of MAS is a perception by its leaders that party fortunes could quickly rebound if the Lusinchi government mishandles the economy. The US Embassy notes that party leaders are ready to take advantage of any mistakes by Lusinchi as he undertakes the nearly impossible task of devising an economic program that will win the support of international lenders without alienating the general populace. Despite its slightly reduced presence in Congress, MAS can count on using that 25X1 forum for criticizing administration policies. Party leaders have stated that they intend to be particularly outspoken on bread-and-butter issues, and we look for them to use every opportunity to try to increase their support in the labor sector, where MAS already has a foothold in the important petroleum and steel unions. [redacted] 25X1

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Lusinchi's Economic Policy Alternatives

If the economy is to achieve long-term growth, we believe Lusinchi will need to make some basic policy adjustments. Lusinchi, by his own admission, does not have a good understanding of economics and, therefore, will be heavily dependent on a small circle of economic advisers from within AD, some of whom hold divergent economic philosophies. In seeking a consensus, we expect Lusinchi to adhere to the blueprint of government outlined in his "Social Pact" pronouncements during the campaign. Never fully developed, the Pact at best represents an attempt to guarantee that all interests are addressed, developed, and respected in the policymaking process. At worst, according to Venezuelan critics, the Pact is a collection of vague, ill-conceived concepts that are unworkable even under the most favorable conditions.

Lusinchi's postelection emphasis on consensus, however, indicates that the Pact may well have some relevance for indicating his preferred style of rule and assessing prospects for his administration. Since we posit that Lusinchi realistically faces three sets of policy options in confronting the country's economic crisis, his preference for political consensus can help gauge which course he is likely to choose.

Self-Imposed Limited Austerity. We believe Lusinchi will most likely attempt to meet the minimal requirements of the international creditors without alienating the AD political machine, its constituency, or nationalist elements. The program, we believe, would include compromises on exchange rate policy that would lower the government's subsidy rate but not go fully to a market rate. Selected retail price increases would help producers cover rising costs. There would also have to be some spending cuts by the public sector to reduce government deficits and slow demand for goods and services.

This approach, however, would still sacrifice long-term economic efficiency for political expediency. Political factors would strongly influence the determination of exchange and interest rates, prices, and wage levels. As a result we would expect a continuation of the economic stagnation that has plagued Venezuela for the last four years.

The IMF Alternative. Throughout 1983 Venezuela resisted accepting an IMF program, despite extensive discussions. According to press reports, the Fund continues to recommend that Caracas gradually unify its present three-tiered exchange system, remove import controls, eliminate consumer price subsidies for food and petroleum, reduce budgetary expenditures, and restrain wages. In formal negotiations with the IMF for a Fund program for Venezuela, the biggest sticking point probably would be the level of public-sector deficit spending. The IMF had sought earlier in 1983 to have the red ink cut by half in 1983 to 2 percent of GDP and called for a surplus in 1984; the Fund now projects, however, that Venezuela's deficit for 1983 will probably turn out to be some 6 percent of GDP. Even if the IMF softens its position somewhat, it still will argue that Venezuela must make headway in cutting public-sector demand. 25X1 25X1

The immediate impact of IMF stipulations would be continued economic contraction at the same time that AD leaders and Lusinchi are faced with domestic pressures for greater public intervention in the economy. Thus, many nationalistic Venezuelans at all levels of society have criticized the IMF alternative as a harsh and unacceptable intrusion on the country's sovereignty. We concur with the US Embassy that, with foreign exchange reserves increasing and an improved balance-of-payments position, the AD expects that it will have a good chance of resolving its financial problems without recourse to IMF programs and their attendant conditions. We believe, however, that Caracas will also need to implement some domestic economic discipline if it expects to receive a rescheduling package from foreign lenders and achieve real economic growth in the longer term. 25X1 25X1

The Nationalist Alternative. Under this option—which we believe is the least likely choice—Lusinchi could try to pursue populist policies and fend off demands by the IMF and international lenders that he get the fiscal house in order. This option might entail: repudiation of the foreign debt, or at least 25X1

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repayment at a self-determined pace, while using the foreign exchange reserves that would be freed up to pay for imports; increased government spending to stimulate the economy; and continued price and exchange rate controls.

We believe that, although there would be some short-term political gains in ignoring economic adjustment policies in favor of stimulation, the costs to Venezuela's longer term economic progress would be enormous:

- Debt repudiation or selective repayment would almost certainly discourage banks from providing the new financing that would be needed to maintain imports once the initial boost to foreign exchange reserves was spent.

- Inflation, fueled by deficit spending, would quickly erase gains in employment and living standards by squeezing real wages and profits, discouraging investment, and eroding the value of the bolivar.

Although the lower-income groups might see short-sighted advantages to such nationalist policies, we believe that the middle and upper classes—which would have to carry the burden of such a plan—would influence Lusinchi to follow a more coherent program.

The Expected Course

Lusinchi's signals to date portend an economic policy that is a troubling mix of austerity and pump priming that will fail to put the economy on the track to longer term development. As such, we believe that it reflects the competing pressures from his economic staff and AD party leaders. Lusinchi's program not only offers incentives to the business sector, but is also packed with promises to labor. According to the US Embassy, he says he would:

- Control inflation with flexible price controls.

- Simplify the current three-tiered exchange rate as quickly as possible into two rates, one for necessary imports—such as raw materials for export goods—and another at the market rate for all other transactions.

- Maintain import controls to encourage import substitution, particularly in agricultural products.

- Depoliticize the oil industry by restoring its financial autonomy. 25X1

- Renegotiate the government's foreign debt without causing "undesirable effects" for the public or worsening Venezuela's balance of payments.

- Improve living conditions for the poor by providing low-cost housing and enhanced employment benefits.

The US Embassy believes that the expansionary policies implicit in this program—in particular the absence of serious belt-tightening measures—are inconsistent with the fiscal cuts that the IMF and even some of Lusinchi's economic advisers feel are needed. US Embassy officers believe, for example, that Lusinchi's program will lead to more public-sector inefficiency and increased state intervention in the economy. A prime target of such intervention, we believe, could be the construction industry, whose reactivation would have a multiplier effect throughout the economy. Such effort would have substantial political benefits for the AD, since credits and contracts can be awarded to party supporters, and housing construction is a continuing political theme by which successive administrations are evaluated. 25X1 25X1

According to the US Embassy's economic sources, if Lusinchi proceeds along the course outlined in his pre-election statements, there will be no formal agreement with the IMF in the next six months. Indeed, in the last weeks of the campaign, Lusinchi and the AD stiffened their resolve not to accept an IMF program. A senior economic adviser to the President-elect emphasizes that Lusinchi will not accept an externally imposed austerity package but intends to resolve the economic problems on his own. He has only agreed to form a committee to conduct talks with the Fund. International creditors have already dropped their insistence on a formal IMF program as a condition for rescheduling the $18 billion short-term debt. [redacted] such a move might set a precedent that could cause other Latin debtors to waver in adherence to their IMF-mandated adjustment programs. [redacted]

We share the US Ambassador's opinion that the reassurances of some AD leaders that proausterity advisers will eventually win Lusinchi's support reflect a minority view within a party that traditionally has employed populist remedies for national problems. For example, AD party leaders concede that price increases will be necessary but contend that—as with the case of gasoline—Lusinchi cannot accept the levels recommended by the IMF. [redacted] The issues in these elections are generally local, but they still involve intense party competition and will invariably be viewed as an early referendum on the new administration. [redacted]

Based on Lusinchi's pronouncements and political predelictions, therefore, we expect he will choose a muddle-through strategy that does not encompass major changes. The US Embassy concludes that this choice will result in zero GDP growth for 1984, an inflation rate that could top 30 percent, and unemployment that could reach 25 percent. It will also increase the present uncertainty among potential foreign and domestic investors and delay the influx of badly needed capital for those firms already committed in Venezuela. [redacted]

Downside Risks

Even the bleak outlook we project for Venezuela's economy in 1984 anticipates a willingness on the part of creditors to show flexibility in refinancing Caracas's external debt. We expect this will occur because of Venezuela's improved balance-of-payments position and solid foreign exchange reserve and because the upturn in economic activity in the OECD countries should assure Venezuela of $15.7 billion in petroleum export earnings in 1984. Similarly, we believe international bankers' moves so far suggest they will be unwilling to force an early showdown that 25X1
would jeopardize their exposure in Venezuela. [redacted] 25X1

If conditions are less favorable, our assessment of the new administration's economic and political problems 25X1
would become even more pessimistic:

- In the event of intransigence on the part of foreign creditors in negotiating a refinancing package, Caracas would more seriously consider the nationalist alternative course and probably adopt portions of it—price and exchange rate controls, increased government spending, and possibly unilaterally setting debt repayment schedules. Ultimately, Venezuela could be forced to adopt severe belt-tightening 25X1
measures to protect its foreign reserves. 25X1

- A collapse of OPEC production quotas and prices or external demand for Venezuelan crude could also 25X1
force Caracas to adopt severe adjustment measures. [redacted] 25X1

An acute economic crisis, especially if mishandled by civilian politicians, would, we posit, lead to severe 25X1
political disruption characterized in its early stages by a broad attack on the governing party. We can realistically envision a scenario that would include:

- Strikes and demonstrations promoted by labor leaders to protect their credibility with rank and file and to prevent radical leftist groups from gaining influence in the labor movement.
- A serious effort by the radical left to present itself as a progressive alternative to a discredited system.
- Eventual military intervention in the political turmoil, supported by the middle class and entrepreneurial sector, who would see such action as neces- 25X1
sary to ward off the radical extremists. [redacted] 25X1

Implications for the United States

Venezuela's relationship with the United States has been traditionally close because of commercial, political, and economic ties. Caracas is a strong proponent of democracy in the hemisphere, the second-largest Latin American market for US goods, and the seventh-largest supplier of petroleum to the United States. In addition, Venezuela's strategic position bordering the Caribbean Basin and anchoring the Andean nations gives it a strong voice in regional affairs.

Within this context, we believe, however, that Venezuela's grim economic outlook and the likelihood of rough political sledding for President Lusinchi will impair bilateral relations. Indeed, according to the US Embassy, Lusinchi rejects the notion of a special US-Venezuelan relationship. The most significant change, in our view, will continue to be felt in trade ties. With a decline in bilateral trade of nearly 25 percent since the beginning of 1982, US commercial interests are being especially hard hit by Venezuela's foreign exchange squeeze.

We believe that, as President, Lusinchi will try to maintain recently imposed import controls. Such a policy would continue to affect adversely many US export-oriented firms, especially those of products not deemed critical to Venezuelan development. According to the most recent trade statistics, US exports to Venezuela have declined some 65 percent from their peak level of $5.8 billion in 1981. US banks, which hold almost half of Venezuela's foreign debt, are also vulnerable if Caracas is unable or unwilling to meet its obligations and forces lenders to write off the credit as bad debt. Such a development—although highly unlikely—would seriously jeopardize the profitability of some US money center banks and could set a precedent for other debtor nations.

We believe that the new administration's preoccupation with economic matters will limit the attention that Lusinchi can devote to foreign policy.[2] His pronouncements on foreign policy have been general, noncontroversial, and similar to the consensus-based "nationalist" policies of previous administrations. His relative silence on Central American issues—except when addressing strictly US audiences—reflects his caution on questions that are controversial at home.

To the extent that Caracas does undertake initiatives in the region, the US Ambassador believes that Venezuelan and US policies are more likely to conflict because of the personalities and ideologies that will chart the new government's course. In particular, Central American policy probably will strongly reflect the views of former President Carlos Andres Perez rather than those of more moderate leaders. Moreover, the leftist bloc in the Congress could press Lusinchi to adjust his foreign policy in order to obtain leftist support for more pressing economic programs.

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